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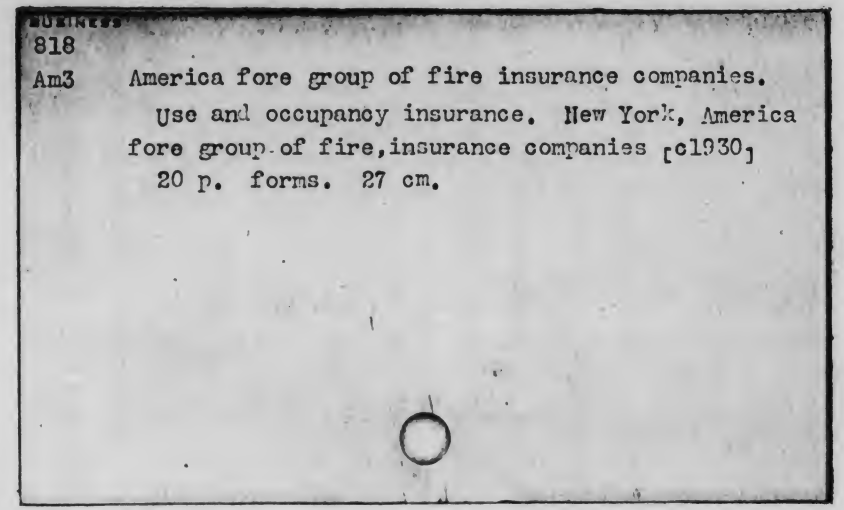
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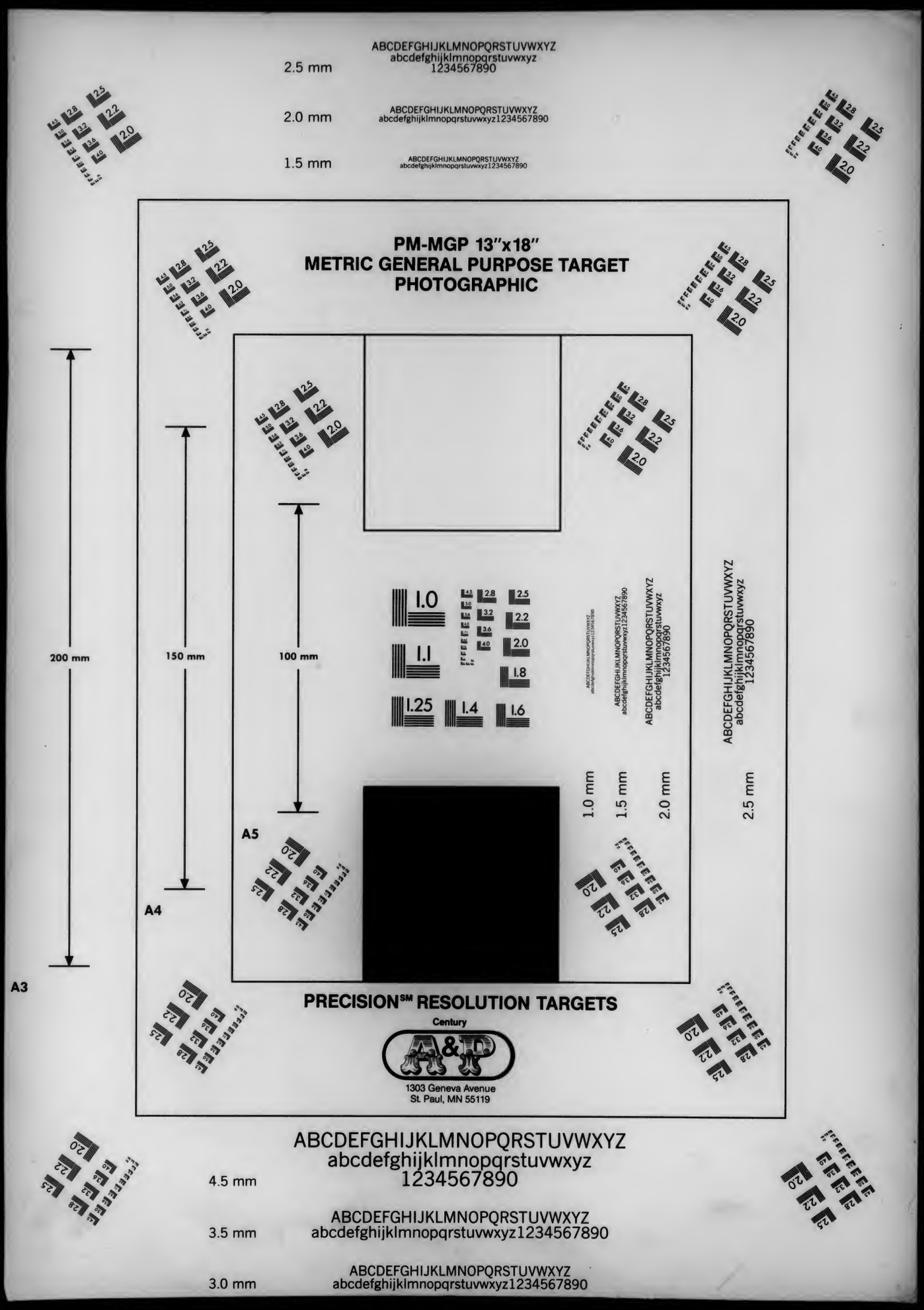
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FOREWORD

IT is the purpose of this booklet to explain briefly the essentials of a form of insurance coverage commonly known as Use and Occupancy insurance. It should be understood that no attempt is made to cover all questions which might arise during negotiations for this class of insurance, nor would such a treatment convey the clear picture which we feel has been embodied in these few pages. A skilled corps of "America Fore" Local Agents, Field Men, and Engineers are ready to help you with your particular insurance problems.

MARCH 1930

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USE AND OCCUPANCY INSURANCE

WHEN fire visits a place of business engaged in the production or distribution of commodities, or engaged in selling "Service" (such as Hotels, Theatres, Laundries, and some Public Utilities), production and sales either diminish or stop entirely. Consequently business earnings either diminish or stop entirely. The straight fire insurance policy takes care of the necessary repairs and replacements as respects the damage to physical property, but it does not pay those standing expenses which must be met whether a business is operating or not. Nor does it provide for the net profits which would have been earned had the fire not interrupted. To insure a business against loss of earnings by reason of interruption by fire, Use and Occupancy insurance was designed. It can be maintained at a moderate premium cost.

How Use and Occupancy Insurance Operates

In its essence, a Use and Occupancy insurance contract operates, during a period of business suspension, to provide the same net earnings that a business would have enjoyed had no interruption occurred. Specifically:

1. *It pays the net profit which a business would have earned.* This means that that portion of Net Profit which is prevented from being earned by a suspension of operations is paid under the insurance policy.

2. *It pays those business charges and expenses which continue during a period of business suspension.* This means that the salaries of officers and other valuable employees, wages of labor, interest on borrowed capital, taxes, and similar business costs which must necessarily continue during a suspension are paid under the insurance policy and not out of the business reserves which usually are needed for other purposes.

3. *It also pays any extraordinary expenses necessary to keep a business operating if possible after a fire,*

when, by so doing, the Use and Occupancy insurance loss can be reduced. This means that the expense of moving into temporary business quarters and the many other extraordinary expenses incidental to emergency operations would be met by the Use and Occupancy insurance contract. In some instances, an immediate replacement of machinery or stock would involve special costs of production or delivery of such machinery or stock. Special expenses such as these are met by this form of insurance. It should be noted that the insurance company's liability under this item is limited to an amount not in excess of that to which the loss under the two preceding items may be reduced by the employment of emergency steps necessary to a speedy resumption of business operations. In other words, the insurance company is quite willing to assist a Use and Occupancy policyholder to reestablish business operations as soon as possible after a fire, but the insurance company will not spend more in so doing than it would have spent had the insured business remained suspended until normal operations could have been resumed.

Suspension Due to Destruction of "Stock"

It is not always the time required to rebuild, repair or replace the damaged premises which causes the entire period of business suspension. After the damaged premises have been placed in full operating condition, the assured's inability to procure stock will often cause an additional period of business suspension. In a manufacturing plant, the time required to replace raw stock and restore it to its state of manufacture at the time of the interruption is a factor to be carefully weighed. Likewise, a mercantile establishment might require an additional period to replace a part or all of its stock before it can resume normal operations. The loss of business earnings resulting from this additional period of suspension may be covered under a Use and Occupancy insurance contract. The extent of this additional period depends upon the nature of the business under consideration and deserves special attention when selecting an appropriate contract of Use and Occupancy insurance. The insurance companies have drafted standard Use and Occupancy insurance forms which are designed to cover the earnings of almost any

enterprise falling into one of the present day major activities. Special forms may be obtained to meet special or unusual conditions.

Actual Loss Sustained

It must always be borne in mind that a Use and Occupancy insurance contract will not provide during a period of business suspension, any more than the amount equal to the "Actual Loss Sustained." To illustrate: An enterprise finds conditions very poor and considers closing down for an extended period. They learn that during this shut-down period their continuing overhead expense would probably be $500 per day. They discover that by operating their plant they could earn $300 of this indispensable overhead expense, thereby reducing their loss to $200 per day. Such a risk, insured under a Use and Occupancy insurance policy would be entitled to collect only $300 per day during a total suspension, thereby placing the policyholder in exactly the same position as he would have been had there been no interruption.

How to Compute the Amount of Insurance

The computation of the amount of Use and Occupancy insurance necessary to protect fully prospective business earnings is a matter for careful consideration. Just as it is necessary to ascertain the value of a building before it can be properly insured under a fire insurance contract, so too is it necessary to analyze the earnings of a business before they can properly be covered under a Use and Occupancy insurance contract. It would be difficult to present a comprehensive and detailed table for analyzing all types of earnings because of the various and intricate accounting practices of modern business. Nevertheless, after considerable research into the methods employed by representative major industries, the "America Fore" group of insurance companies has prepared a "*Use and Occupancy Insurance Chart showing in flow line the proper procedure for determining the amount of insurance necessary for complete coverage under current forms.*" A reproduction of this chart, properly filled in, is inserted in this booklet and is accompanied by a detailed explanation.

Selection of an Appropriate Form

Too much stress cannot be laid on the importance of selecting the form of Use and Occupancy insurance contract which offers the most complete coverage for the type of business earnings under consideration. Just as some earnings are constant, or fluctuate during definite periods usual to certain classes of business, so

too do the earnings of other classes of business fluctuate according to weather conditions or other indefinite seasonal influences. It is necessary therefore, to select the form which is most adaptable to the particular characteristics of the earnings under consideration. Usually, a standard form will cover all phases of a business. However, where necessary, special forms may be obtained to meet the special conditions which surround certain types of business.

Blanket Coinsurance Use and Occupancy Form

The earnings of many present-day enterprises fluctuate in such a manner that it would be quite impossible to estimate at the beginning of any policy year the periods of busy or slack operations. To meet the need for a comprehensive coverage on this type of earnings, the Coinsurance Use and Occupancy form was devised. For sake of comparison we shall liken it to a blanket fire insurance policy form. The Coinsurance Use and Occupancy form provides blanket cover without specifying a daily or weekly limit of liability. All that is necessary to secure proper protection is the maintenance of sufficient insurance to comply with the coinsurance provision of the policy.

The earnings of a department store offer a good example of retail distribution which could be advantageously insured under the Blanket Coinsurance form. It should not be difficult for the average department store operator to approximate closely the full annual business expected during a next ensuing twelve-month period, but it might be difficult for him to foresee the fluctuations of these earnings and the periods during which they will occur. The Blanket Coinsurance form covers this situation with a minimum of guesswork.

However this is not meant to imply that the Blanket Coinsurance form is not readily adaptable to cover the earnings of the producer (manufacturer), wholesale distributor, or "Service" organization. Always the type of earnings will have a bearing on the selection of the most desirable form.

The Blanket Coinsurance form is divided into two insuring items, as follows:

Item I. $.....On (*a*) the net profit which is thereby prevented from being earned and

(*b*) such charges and other expenses, including salaries of officers—executives—department managers—employees

(*Turn to Page 13*)

TABLE No. 1

SHOWING THE OPERATIONS OF A PAST FISCAL YEAR NECESSARY FOR DETERMINING A BASIC ESTIMATE OF AMOUNT OF INSURANCE FOR THE NEXT ENSUING YEAR

A. INCOME

1. Income from Net Sales for Fiscal Year ending Oct 31, 1929 $100,000
2. Income from other Operating Sources (if any) for same period $ 1,700
3. Income from Net Sales and from other Operating Sources $101,700

B. DEDUCTIONS

1. Inventory at beginning of Fiscal Year $ 17,600
2. Net Cost of Purchases during that period $ 65,500
3. Total Value to be accounted for $ 83,100
4. Less Inventory at end of Fiscal Year $ 16,900
5. Net Value to be accounted for at end of that period $ 66,200
6. Add Other Eliminations or Exclusions (if any) $ 2,600
7. Total Amount to be deducted from Income $ 68,800

C. BASIS FOR INSURANCE

1. Actual Amount based upon experience of past Fiscal Year $ 32,400
2. Prospective increase (or decrease) for next Fiscal Year $ 1,500
3. BASIC ESTIMATE to be adjusted by TABLE No. 2 or TABLE No. 3 $ 33,900

USE AND OCCUPANCY INSURANCE CHART

SHOWING IN FLOW LINE

THE PROPER PROCEDURE FOR DETERMINING THE AMOUNT OF INSURANCE NECESSARY FOR COMPLETE COVERAGE UNDER CURRENT FORMS

This Chart has been arranged as a flow-sheet, the operations first proceeding through the A-B-C steps to an estimated amount based upon the actual figures of a preceding year. This amount is next carried over to work-out tables for adjustment to an amount required for full insurance coverage. It will be found that the flow line method of presentation will greatly simplify explanations so often found needed in preliminary negotiations.

It must be understood that the operations shown on the Chart may not bring out all factors requiring consideration in certain risks. Such factors, when discovered through survey or otherwise must be properly weighed and entered into the computations if found to have a bearing on the final result. Nor must it be assumed that the Chart has been so designed as a work-sheet that a scratch pad will not be required on the side. Accompanying this Chart is an Explanation of the details of its operations.

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TABLE No. 2

Adjustment of the BASIC ESTIMATE (C-3) for Coverage Under BLANKET CO-INSURANCE FORM

ITEM I

1. BASIC ESTIMATE (C-3) $ 33,900
2. Full Annual Ordinary Payroll $ 10,500
3. Full Cost of Heat, Light and Power $ 600
4. Total of No. 2 and No. 3 (deduct from No. 1) $ 11,100
5. Insurance necessary under ITEM I of Form $ 22,800 Rate .80 Prem. $ 182.40

ITEM II

1. Full Ordinary Payroll for largest 90 consecutive days $ 3,000 Rate 1.25 Prem. $ 37.50

FINAL AMOUNT for Coverage under BLANKET CO-INSURANCE FORM (Total Items I and II) $ 25,800 Av. Rate .857 Prem. $ 219.90

NOTE: The BLANKET CO-INSURANCE FORM is adaptable for coverage of earnings of all classes of business, and in many cases provides complete coverage at lower costs than other forms. It is especially designed to cover earnings of those businesses where such earnings are subject to marked fluctuations, seasonal or otherwise.

TABLE No. 3

Adjustment of the BASIC ESTIMATE (C-3) for Coverage Under FORMS OTHER THAN BLANKET CO-INSURANCE FORM

COLUMN I: Place opposite the proper item all operating charges and expenses anticipated for next ensuing year.

COLUMN II: Place opposite the proper item those expenses (or portions thereof) which could be discontinued during interruption, care being taken not to limit the coverage which the policy contract permits.

	COLUMN I	COLUMN II
1. Interest on Borrowed (or owned) Capital	$ 2,100	$ NONE
2. Taxes	450	"
3. Rentals	3,700	"
4. Advertising and publicity	2,200	"
5. Salaries of Officers and Indispensable employes	5,000	"
6. Other Salaries (Ordinary Pay Roll)	10,500	6,000
7. Heat, Light and Power	600	600
8. Insurance premiums	600	NONE
9. Maintenance, Repairs and Depreciation	1,650	"
10. Other operating charges and expenses	2,350	1,200
TOTALS OF COL. I AND COL. II	$ 30,150	$ 7,800

TOTAL ANTICIPATED OPERATING CHARGES AND EXPENSES (COL. I) $ 30,150

ESTIMATED NET PROFIT (OR LOSS) $ 3,750

RESULT (MUST EQUAL BASIC ESTIMATE C-3) $ 33,900

LESS COLUMN II $ 7,800

FINAL AMOUNT for Coverage UNDER OTHER FORMS $ 26,100 Rate .89 Prem. $ 213.76

NOTE: OTHER FORMS have been designed primarily to cover earnings of businesses where such earnings are constant or are subject to established fluctuations during definite periods, usual to certain businesses. TABLE NO. 3, when properly used, will also serve to verify or modify the Basic Estimate (C-3) as determined by the operations of TABLE NO. 1.

(Continued from Page 8)

under contract and other important employees, as must necessarily continue during a total or partial suspension of business, to the extent only that such charges and expenses would have been earned had no fire occurred.

This Item (I) covers expense of necessary heat, light or power, the cost of which is prevented from being earned during the time of total or partial suspension of business caused by fire. This Item (I) *does not cover* any portion of the insured's ordinary payroll described in Item II.

Item II. $.....On the insured's entire ordinary payroll for a period of time not in excess of ninety (90) consecutive days immediately following loss or damage by fire, which may continue during a total or partial suspension of business, covering only to the extent necessary to resume the normal business of the insured with the same quality of service which existed immediately preceding the fire, and which would have been earned had no fire occurred.

This Item (II) *does not cover* any portion of salaries described in Item I.

The effect of this division is as follows:

Under Item I, full protection is given on that portion of earnings where it is needed. That is to say, on the sum (1) of Net Profit and (2) of all annual operating charges and expenses, after deducting:

(*a*) The full annual cost of Heat, Light and Power, which, while not included in the *amount of insurance* required under this item, is nevertheless included in the *coverage* without premium charge, and;

(*b*) The full annual cost of Ordinary Payroll. This is dealt with under Item II.

Under Item II, a reduction in the amount of insurance is permitted on that portion of earnings where full annual coverage is not needed. In the past, many prospective Use and Occupancy insurance policy-holders strenuously objected to maintaining full annual insurance coverage on full ordinary payroll when it was known that under no circumstances could they suffer a loss on ordinary payroll for a period in excess of, say, ninety days. Recognizing the logic of this, and wishing to meet the prospective policy-holders' objection in a constructive manner, the insurance companies drafted the Blanket Coinsurance form. In consequence, the policy-holder enjoys complete coverage by maintaining only the amount of insurance required for his actual needs, and thus paying a lower premium cost.

Where earnings are constant or are subject to fluctuations during definite periods usual to certain classes of business, the Blanket Coinsurance form need not

Other Use and Occupancy Forms

necessarily be used. There are certain other Use and Occupancy insurance forms which have been designed to cover earnings of the constant or definite type. These forms do not cover in a blanket manner and are quite inelastic. They must, therefore, be used with caution. In a few instances, these other forms will provide complete coverage at a lower premium cost than the Blanket Coinsurance form, but as a rule the premium cost is approximately the same. It is our opinion that all other Use and Occupancy insurance forms will be discarded in favor of the Blanket Coinsurance form as soon as the superior features of the Blanket form are generally understood.

Contingent Use and Occupancy Insurance

A business enterprise may be seriously crippled by fire damage to or destruction of some property other than that used and occupied by a policy-holder. For example, damage to or destruction of an outside power plant, or some institution on which the policy holder may be dependent for parts or processing of parts entering into the finished product, or a plant to which the policy-holder's product is sold, could prove as disastrous to the policy-holder's earnings as an interruption caused by damage to or destruction of the premises occupied by him. The loss of earnings resulting from a remote cause of this description may be covered under a form of insurance contract known as *Contingent Use and Occupancy Insurance.* Due consideration should be given to the possibility of a business interruption by reason of a remote occurrence when surveying a business in preparation for Use and Occupancy insurance.

Hazards Against Which We Insure

Of course, a Fire is not the only calamity that causes an interruption of business earnings. In addition to insuring a business against loss of earnings by Fire, the "America Fore" group of insurance companies also insures earnings against interruption by Windstorm, Explosion, Riot and Civil Commotion, Sprinkler Leakage, by the explosion of Steam Boilers and pressure vessels, by the bursting of Fly Wheels and Pulleys, and by the breakdown of Engines, Turbines, and Electrical Machinery. The presence of any or all of these hazards will differ according to the conditions surrounding the operations of various businesses. All phases of possible interruption and causes should be given special consideration when determinining the Use and Occupancy insurance needs of an enterprise.

EXPLANATION OF USE AND OCCUPANCY INSURANCE CHART

(As reproduced on Pages 10 and 11)

Three important factors must be determined before intelligent consideration can be given to Use and Occupancy insurance by a prospective policy-holder. These are:

1. The amount of Use and Occupancy insurance necessary for complete coverage.
2. The form of policy best suited to the type of business earnings under consideration.
3. The premium cost of such a form of policy.

To help establish these, the accompanying chart has been made. It illustrates an actual computation for a mercantile class and develops the above three factors in flow line method. The computation for either a manufacturing or a "Service" class of business would appear in similar fashion. The chart is composed of three tables which are designated as:

Table No. 1

Table No. 1—Showing the results of a past fiscal year necessary for determining a basic estimate of the amount of insurance required for the next ensuing year.

Table No. 2—Showing the adjustment of the Basic estimate for complete coverage under the Blanket Coinsurance form and the premium cost for insurance under this form.

Table No. 3—Showing the adjustment of the Basic estimate for complete coverage under forms other than the Blanket Coinsurance form and the premium cost for insurance under whichever one of the other forms is selected.

It will be noted that table number one is divided into three major steps designated as A–B–C. These are intended to utilize a statement showing the results of a past fiscal year's operations in order to arrive at a basis for estimating the results expected during the next ensuing year.

This table is intended to serve as a guide for separating *Income* of a past fiscal year from operating sources (Step A) into two parts, First, that part which is *not* Use and Occupancy insurance value (Step B), and;

Second, that part which *is* to be used as a basis for estimating the amount of Use and Occupancy insurance necessary to properly protect the earnings of the next fiscal year's operations (Step C). In detail, the steps are as follows:

Step "A"—Income

A1—The amount inserted here is the net income from Sales (or Service) after discounts, returns and allowances have been made.

A2—In many businesses, there are certain items of income which are not derived from Sales, but nevertheless are from sources directly dependent on continued business operations for their existence. Usually, these are covered under a Use and Occupancy insurance policy and should be added to income from Net Sales (or Service) at this point. Do not include credit items such as interest earned on bank balances, or interest received on securities owned by the business or any similar item of income not directly connected with or produced through business operations, for its continuance.

A3—The amount inserted here represents the total of Steps A1 and A2, or in essence, the "Income from Operations."

Step "B"—Deductions

That part of income which is disbursed for the purchase of raw stock, materials and supplies entering into the finished product of a manufacturing plant or for the purchase of stock and supplies to be sold by a mercantile establishment (or for the supplies of a "Service" organization) is not properly included in the amount to be used as a basis for Use and Occupancy insurance, and it must, therefore, be deducted. Then, too, there are certain other miscellaneous costs which should be deducted. Step B demonstrates, in a general way the procedure to be followed in determining the amount to be deducted from Operating Income of a past fiscal year to arrive at an actual basis for estimating future Use and Occupancy insurance requirements.

B1—The amount entered here represents the inventory of all stock, materials and supplies on hand at the beginning of the fiscal year.

B2—The amount entered here represents the net cost of purchases (including incoming freight) of stock (or raw stock) and materials and supplies, after discounts, returns, and allowances have been taken. This

amount should not include any labor cost or overhead expense which should be properly left in the amount to be used as a basis for estimating Use and Occupancy insurance needs of the next fiscal year.

B3—The amount inserted here represents the total value to be accounted for in respect to the past fiscal year's operations.

B4—The amount entered here represents the value of all stock, materials, and supplies on hand at the end of the past fiscal year's operations after due consideration has been given to actual depreciation or appreciation.

B5—The amount entered here is the difference between B3 and B4 which results in the net value to be accounted for in respect of the past fiscal year's operations.

B6—The amount entered here represents those costs which do not enter into the net cost of purchases and yet are not to remain in the basis for estimating Use and Occupancy insurance coverage. Principal among these are bad debts, inter-departmental purchases which might produce a fictitious net Sales figure, or disbursements in respect of some non-operating expense which are actually offset by non-operating income, but are charged on the books against operating income. The items entered here, if any, will differ in each class of business and must receive careful consideration.

B7—The amount entered here represents the sum of B5 and B6 or the total amount to be deducted from Income.

Step "C"—Basis for Insurance

C1—The amount entered here represents the difference between the amount entered under Step A3 (Operating Income) and Step B7 (Deductions). This difference is the amount from which all salaries, wages, overhead charges and expenses of the business were paid before the operating net profit for the past fiscal year could be established. This result is the actual amount which retrospectively would have been used as a Basis for Use and Occupancy insurance to cover the earnings of a past fiscal year.

C2—The amount entered here represents the prospective increase (or decrease) in the actual amount (C1 as produced by a past fiscal year's operations) to contemplate the next fiscal year's operations.

C3—The amount entered here represents the estimated results to be produced by the next twelve months operations and the basic estimate upon which the proper amount of Use and Occupancy insurance is predicated. As the next twelve months pass, it would be advisable to check this estimated amount against the actual operating results at intervals of not more than 90 days. Then there can be made any necessary adjustment in the amount of Use and Occupancy insurance required to parallel the business trends which were unforeseen at the time the policy was written.

Following this point, two work-out tables are available, one for the Blanket Coinsurance form (Table 2) and one for forms other than the Blanket Coinsurance form (Table 3). It is suggested that both tables be used in order to compare the premium cost of the Blanket Coinsurance form with the premium cost of any other form. This, with a view to adopting the Blanket Coinsurance form wherever possible, even though one of the other forms might be considered suitable.

Table No. 2

This table is a guide for use in the adjustment of the Basic Estimate (Table 1—Step C_3) for coverage under the Blanket Coinsurance form. It divides the Basic Estimate into the two items as required for coverage under the Blanket Coinsurance form.

Item I—Under this section of Table 2 are the steps necessary to arrive at the amount of insurance required under Item I of the Blanket Coinsurance form in order to comply with the provisions of the Coinsurance Clause as it applies to Item I. The first amount entered is the Basic Amount (Table 1—Step C_3). From this is deducted the combined cost of Full Annual Ordinary Payroll and the Full Annual Cost of Heat, Light and Power. The remaining difference is the amount of insurance necessary under Item I of the form. To this amount is applied the Item I rate which produces the premium cost for insurance under Item I.

Item II—Under this section is inserted the amount of *Full Ordinary Payroll* for the largest 90 consecutive days of the year. To this amount is applied the Item II rate which produces the premium cost for insurance under Item II (if desired).

The final operation of this Table shows the total amount of insurance to be maintained under the

Blanket Coinsurance Form, the average rate applicable, and the total premium cost.

Table No. 3

This table serves as an important feature of this Use and Occupancy Insurance Chart. By its use, it is possible to check the Basic Estimate as determined through the A-B-C Steps of Table 1. Table 1 arrives at the Basic Estimate through a process of elimination. Table 3 reverses this process and builds up an amount which must agree with the Basic Estimate produced through the A-B-C Steps of Table 1.

Column I—Opposite each item is entered the full annual charge or cost anticipated for the next ensuing year. The total of Column I should represent the full annual operating charges and expenses anticipated for the next ensuing year. Add to the total of Column I the estimated Net Profit (or deduct in case of a Loss) expected on the next fiscal year's operations. It must be understood that this estimate might differ from the Net Profit (or Loss) as shown by the Profit and Loss Statement, but, under Use and Occupancy insurance we are interested only in that portion of Net Profit (or Loss) which is produced through business operations, not extraneous sources. The result should equal the Basic Estimate produced through the A-B-C Steps of Table 1. If it does not agree, all amounts entered in Tables 1 and 3 should be carefully checked, particular attention being given to the prospective increase or decrease entered under Step C_3 of Table 1 and the expected estimated Net Profit (or Loss) as entered in the final steps of Table 3.

Column II—While the amount of insurance required under the Blanket Coinsurance form is based on full annual amounts of operating charges and expenses, whether or not they continue after an interruption of business, the amount for coverage under other forms is based on those operating charges and expenses which continue after an interruption. In fact, very few items of expense could be discontinued during a short business suspension, whereas many operating expenses would be discontinued during a prolonged total business suspension. It is recommended therefore that only those items (or portions thereof) which would be discontinued during a short suspension be selected and entered under Column II of Table 3.

It is then necessary to deduct the total of Column II from the Basic Estimate in order to arrive at the Final Amount of Insurance required under forms other than the Blanket Coinsurance form.

To this difference is applied the proper rate which produces the premium cost for the amount of Use and Occupancy insurance required under a form other than the Blanket Coinsurance form.

Additional copies of this pamphlet or copies of a full working size Chart with Explanation, may be had by application to any "America Fore" Local Agent, Special Agent, Engineer or Departmental Office.

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